

Message Text

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ACTION ARA-14

INFO OCT-01 ISO-00 AGRE-00 DOE-15 SP-02 ICA-11 AID-05

EB-08 NSC-05 TRSE-00 SS-15 STR-07 OMB-01 CEA-01

CIAE-00 COME-00 FRB-03 INR-10 NSAE-00 XMB-02

OPIC-03 LAB-04 SIL-01 SOE-02 H-01 L-03 PA-01

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R 211910Z JUN 78

FM AMEMBASSY BRASILIA

TO SECSTATE WASHDC 7980

INFO AMCONSUL RIO DE JANEIRO

AMCONSUL SAO PAULO

C O N F I D E N T I A L SECTION 1 OF 2 BRASILIA 4881

E.O. 11652: GDS

TAGS: ETRD, EFIN, BR

SUBJECT: BRAZIL'S FOREIGN DEBT AND DEBT SERVICE: PRELIMINARY
PROJECTIONS 1978-81

REFS: (A) BRASILIA 1526, (B) BRASILIA 2137 (C) BRASILIA 3058

(D) JOHNSON-LOHMANN TELCON, 12 JUN 78

1. SUMMARY. BASED ON INCOMPLETE FOREIGN DEBT DATA FOR 1977 AND CURRENT EXPECTATIONS FOR DETERIORATION OF BRAZIL'S TRADE ACCOUNT IN 1978, THE EMBASSY IS PROJECTING GROSS FOREIGN DEBT OF \$37 BILLION BY THE END OF THE YEAR. THE INCREASE IN BORROWING NEEDS IN 1978, COMBINED WITH ASSUMPTIONS ON THE GROWTH OF EXPORTS, IMPORTS, AND SERVICES IN THE PERIOD 1979-81, SUGGESTS THAT BRAZIL'S FOREIGN DEBT COULD REACH \$47 BILLION BY 1981. THE IMPLIED INCREASE IN GROSS DEBT SERVICE WOULD CLAIM A MAXIMUM OF 70 PERCENT OF BRAZIL'S RECEIPTS FROM EXPORTS OF GOODS AND SERVICES IN 1979 AND THEN DROP TO 60 PERCENT IN 1981. BRAZIL'S GROSS FOREIGN DEBT MINUS GROSS RESERVES WOULD REMAIN AT MORE THAN DOUBLE THE COUNTRY'S ANNUAL EXPORTS IN 1978-81 AFTER PEAKING AT 2.5 TIMES
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EXPORTS IN 1978. BRAZIL'S ABILITY TO CONTINUE BORROWING HEAVILY IN THE NEXT FEW YEARS WILL DEPEND ON MAY FACTORS WHICH REMAIN UNCERTAIN AT THIS TIME. HOWEVER, BRAZIL WILL HAVE NO DIFFICULTY MEETING ITS FINANCING NEEDS IN 1978 AND TERMS AND CONDITIONS ON BRAZIL'S BORROWING HAVE IMPROVED MARKEDLY IN THE LAST 6 MONTHS. END SUMMARY.

2. INTRODUCTION. ALTHOUGH FOREIGN DEBT DATA FOR END-1977 ARE NOT YET AVAILABLE FROM CENTRAL BANK, EMBASSY HAS MADE TENTATIVE ANALYSIS OF DEBT SERVICE OVER THE MEDIUM TERM FOR WASHINGTON AGENCIES' REFERENCE AND USE. SUBJECT MERITS ATTENTION BECAUSE OF IMPACT OF TEMPORARY SETBACK IN TRADE ACCOUNT IN 1978 ON BRAZIL'S ABILITY TO BORROW ABROAD AND TO SERVICE ITS FOREIGN DEBT. THE FOLLOWING IS BASED ON CENTRAL BANK DATA FOR GROSS FOREIGN DEBT AT END SEPTEMBER 1977 (\$30.1 BILLION), CURRENT OFFICIAL FIGURE OF GROSS DEBT OF \$32 BILLION AT END OF 1977, AND EMBASSY PROJECTIONS FOR 1978-81. EMBASSY WILL UNDERTAKE MORE COMPREHENSIVE ANALYSIS AND REPORT WHEN END 1977 DATA BECOME AVAILABLE.

3. TRADE DEFICIT AND INCREASED FINANCING REQUIREMENTS.

THE PROLONGED DROUGHT IN BRAZIL'S CENTRAL SOUTH STATES HAS ADVERSELY AFFECTED AGRICULTURAL PRODUCTION AND EXPORTABLE SURPLUS FOR 1978. THE EFFECTS OF THE DROUGHT COMBINED WITH LOWER WORLD COFFEE PRICES THAN ANTICIPATED EARLIER IN THE YEAR, ARE EXPECTED TO HAVE A NET ADVERSE IMPACT OF PERHAPS \$1.5 BILLION ON BRAZIL'S TRADE ACCOUNT (REF C). DEFINITIVE INFORMATION ON CROP YIELDS IS NOT YET IN BUT WE BELIEVE TOTAL EXPORTS MAY DECLINE BY ABOUT 4 PERCENT FROM THE 1977 LEVEL BASED ON AN 18 PERCENT DROP IN AGRICULTURAL EXPORTS OFFSET IN PART BY 21 PERCENT GROWTH IN INDUSTRIAL EXPORTS. CONFIDENTIAL

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IMPORTS OF FOODSTUFFS WILL BE PERHAPS \$400 MILLION HIGHER BECAUSE OF THE DROUGHT BUT RECENT GOB CUTS IN IMPORTS OF STATE ENTERPRISES ARE AIMED AT KEEPING TOTAL IMPORTS MORE OR LESS CONSTANT AT LAST YEAR'S LEVEL. THE RESULTING EXPORTS OF \$11.6 BILLION AND IMPORTS OF \$12.1 BILLION WOULD PRODUCE A TRADE DEFICIT OF \$500 MILLION. THIS TURNAROUND OF APPROXIMATELY \$1 BILLION FROM THE EMBASSY'S FIRST PROJECTIONS FOR 1978 (REF A IMPLIES INCREASES IN THE CURRENT ACCOUNT DEFICIT TO \$5.2 BILLION, A GROSS FINANCIAL GAP OF \$10.4 BILLION, AND A BORROWING REQUIREMENT OF \$9.6 BILLION AFTER ASSUMING DIRECT FOREIGN INVESTMENT OF \$800 MILLION.

4. DEBT AND DEBT SERVICE: 1978. TECHNICAL PERSONNEL OF THE CENTRAL BANK ARE CONFIDENTIALLY EXPECTING GROSS FOREIGN DEBT TO REACH \$36-37 BILLION AT THE END OF 1978. FOR PURPOSES OF OUR EXERCISE, EMBASSY IS PROJECTING DEBT OF \$37 BILLION ON ASSUMPTION THAT BRAZILIAN AUTHORITIES WILL MAINTAIN THE CURRENT LEVEL OF GROSS FOREIGN RESERVES OF \$7.5 BILLION. THIS IMPLIES \$300 MILLION INCREASE IN 1978 AND NET FOREIGN DEBT OF \$29.5

BILLION AT THE END OF 1978. DUE MAINLY TO THE RAPID INCREASE IN BORROWING IN 1974-77, TOTAL DEBT SERVICE (AMORTIZATION PLUS GROSS INTEREST PAYMENTS) IS PROJECTED TO RISE SHARPLY FROM \$6.5 BILLION IN 1977 TO \$8.1 BILLION IN 1978. THIS TOTAL CONSISTS OF \$5.2 BILLION IN AMORTIZATION AND \$2.9 BILLION INTEREST. THE MOST CONSERVATIVE MEASURE OF DEBT SERVICE CAPACITY, THE RATIO OF MERCHANDISE EXPORTS ONLY TO GROSS DEBT SERVICE, WOULD RISE FROM .537 IN 1977 TO NEARLY 70 PERCENT (.698) IN 1978. EVEN THE LEAST CONSERVATIVE INDICATOR, EXPORTS OF GOODS AND SERVICES TO NET DEBT SERVICE (GROSS DEBT SERVICE MINUS INTEREST EARNINGS) WOULD REACH NEARLY 60 PERCENT (.596). A THIRD RATIO, TO WHICH THE GOB FREQUENTLY REFERS, IS CONFIDENTIAL

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NET DEBT AT YEAR-END COMPARED TO MERCHANDISE EXPORTS DURING THE YEAR, WHICH WOULD RISE FROM 2.05 IN 1977 TO 2.54 IN 1978. THESE FIGURES ALL DIRECTLY REFLECT THE DETERIORATION OF THE TRADE BALANCE AND ARE OF COURSE HIGHER THAN THE PROJECTIONS CONTAINED IN REF B.

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C O N F I D E N T I A L SECTION 2 OF 2 BRASILIA 4881

5. DEBT AND DEBT SERVICE: 1979-81: TENTATIVE EMBASSY PROJECTIONS FORESEE BRASIL'S GROSS FOREIGN DEBT RISING STEADILY OVER THE NEXT THREE YEARS AND REACHING \$47 BILLION BY THE END OF 1981. THE RATE OF GROWTH IN THE DEBT WOULD DECLINE EACH YEAR AS AN IMPROVING TRADE BALANCE WOULD OFFSET RISING INTEREST PAYMENTS AND PERMIT SMALLER CURRENT ACCOUNT DEFICITS AND GROSS BORROWING NEEDS. ASSUMING EXPORT RECOVERY OF 15 PERCENT IN 1979 AND ANNUAL GROWTH OF 12 PERCENT IN 1980-81, AND IMPORT GROWTH OF 5 PERCENT PER ANNUM IN 1979-81, BRAZIL WOULD HAVE A TRADE SURPLUS OF \$2.7 BILLION IN 1981. THERE ARE MANY UNCERTAINTIES REGARDING ANY SUCH PROJECTIONS (E.G. ECONOMIC GROWTH IN THE INDUSTRIAL COUNTRIES, WORLD COFFEE PRICES, ETC.) BUT DIVERSIFICATION OF BRAZIL'S EXPORTS AND EXPORT MARKETS AND THE ANTICIPATED FAVORABLE IMPACT OF MAJOR IMPORT SUBSTITUTION PROJECTS SUGGEST THESE EXPECTATIONS ARE NOT UNREASONABLE. WE ALSO ASSUMED ANNUAL GROWTH OF 7 PERCENT IN NON-INTEREST SERVICE PAYMENTS, 10 PERCENT IN SERVICE RECEIPTS AND MAINTENANCE OF \$7.5 BILLION IN GROSS RESERVES BY FOREIGN BORROWING AT AVERAGE 8-9 PERCENT PER ANNUM INTEREST, 7 YEARS
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MATURITY, AND 30 MONTHS GRACE. ON THESE BASES, THE CURRENT ACCOUNT DEFICIT WOULD DECLINE TO \$3.5 BILLION IN 1981, AND AMORTIZATION WOULD LEVEL OFF AT \$6.1 BILLION. THE FINANCIAL GAP WOULD PEAK AT \$10.7 BILLION IN 1979 AND THEN DROP SLOWLY TO \$9.6 BILLION IN 1981. GROSS DEBT SERVICE WOULD RISE FAIRLY SHARPLY IN 1979 TO \$9.5 BILLION BUT THEN MORE SLOWLY TO \$10.1 BILLION IN 1981. THIS MORE GRADUAL RATE OF INCREASE IS MAINLY ATTRIBUTABLE TO THE EXTENSION IN 1977 OF THE GRACE PERIOD ON NEW MEDIUM AND LONG-TERM BORROWING TO 30 MONTHS AND THE FACT THAT BRAZIL TODAY IS OFTEN SECURING GRACE PERIODS OF 36-48 MONTHS.

6. DEBT SERVICE CAPACITY: 1979-81. THE RATIO OF NET DEBT TO EXPORTS WOULD DECLINE STEADILY AFTER 1978 BUT WOULD STILL BE 2.37 IN 1981, OR WELL ABOVE THE 1977 LEVEL. GROSS DEBT SERVICE WOULD REQUIRE A PEAK 71 PERCENT OF MERCHANDISE EXPORTS RECEIPTS IN 1979 BUT DROP TO 60 PERCENT IN 1981. NET DEBT SERVICE WOULD BE EQUIVALENT TO 60 PERCENT OF EXPORTS OF GOODS AND SERVICES IN 1979 AND 52 PERCENT IN 1981. IN ORDER FOR THE VARIOUS MEASURES OF DEBT SERVICE CAPACITY TO RETURN TO THE LEVELS REGISTERED IN 1977, BRAZIL WOULD NEED EXPORT GROWTH OF 20 PERCENT IN 1980-81, OR SOME COMBINATION OF LOWER IMPORTS AND NET SERVICES WITH THE EQUIVALENT IMPACT (I.E. ABOUT \$2.5 BILLION IN 1981). TWO VARIABLES ARE ESPECIALLY IMPORTANT: THE COST OF PETROLEUM AND PREVAILING INTEREST RATES IN EURODOLLAR MARKETS. GIVEN BRAZIL'S CURRENT PETROLEUM

IMPORT BILL OF ABOUT \$4 BILLION, EVERY 5 PERCENT INCREASE
IN PRICE WOULD RAISE THE ANNUAL BALANCE OF PAYMENTS
COSTS BY \$200 MILLION. ASSUMING FOR ILLUSTRATIVE PURPOSES
FOREIGN DEBT OF \$40 BILLION SUBJECT TO FLOATING RATES,
A 1 PERCENTAGE POINT INCREASE IN LABOR IMPLIES
INCREASED INTEREST PAYMENTS OF ABOUT \$400 MILLION PER
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YEAR. THESE COSTS WOULD BE OFFSET BY INCREASED
EARNINGS OF \$75 MILLION ON BRAZIL'S GROSS FOREIGN
RESERVES BUT THE NET NEGATIVE IMPACT WOULD STILL BE
\$325 MILLION. EVEN SUCCESS WITH INCREASED DOMESTIC
OIL EXPLORATION WOULD HAVE LITTLE FAVORABLE EFFECT ON
IMPORT NEEDS IN THE NEAR-TERM, AND FOREIGN DIRECT
INVESTMENT AND FIXED INTEREST BOND ISSUES ABROAD,
COMBINED, WILL PROBABLY NOT ACCOUNT FOR MORE THAN
\$2-2.5 BILLION OF BRAZIL'S ANNUAL FINANCING NEEDS IN
THE PERIOD 1979-81.

7. SUBSEQUENT ANALYSIS AND REPORTING WILL DEAL WITH
BRAZIL'S CREDITWORTHINESS AND ABILITY TO CONTINUE TO
BORROW HEAVILY ABROAD. SUFFICE IT TO SAY AT THIS TIME
THAT: A) MANY FACTORS WILL BE IMPORTANT, INCLUDING
ECONOMIC GROWTH, POLITICAL STABILITY, THE IMAGE OF
BRAZIL'S ECONOMIC POLICY-MAKERS, AND INTERNATIONAL
BANK LIQUIDITY AND THE DEMAND FOR FINANCING BY
ALTERNATIVE BORROWERS; B) BRAZIL'S ABILITY TO BORROW
IN 1978 IS VERY GOOD AND INTEREST RATE SPREADS
HAVE DECLINED AND MATURITIES LENGTHENED DESPITE INCREASED
RECOURSE TO FOREIGN MARKETS.
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